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MICHAEL W. DOBBINS
CLERK, U.S. DISTRICT COURT

**UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION**

Aero Products International, Inc., a Florida
corporation, and Robert B. Chaffee, an
individual,

Plaintiff,

vs.

Intex Recreation Corp., a California
corporation, Quality Trading, Inc., a California
corporation, and Wal-Mart Stores Inc., a
Delaware corporation,

Defendants.

Case No.: Case No. 02 C 2590

Judge John W. Darrah

Magistrate Judge Geraldine Soat Brown

**MEMORANDUM IN SUPPORT OF MOTION OF DEFENDANT INTEX
RECREATION CORP. TO STAY AWARD OF DAMAGES FOR G1 SALES
PENDING AN EVIDENTIARY HEARING**

I. INTRODUCTION.

This Court's Memorandum and Order of May 11 directs Defendant Intex Recreation Corp. ("IRC") to provide, among other things, an accounting of the sales of the products with the "G1" design that the Court has now found to infringe the '726 patent. ("G1 design products"). IRC is proceeding to provide an accounting of such sales as ordered by the Court; however, it is also clear that the record includes no evidence upon which the Court may base an award of a royalty on these products.

Plaintiffs' motion for a "supplemental" damages calculation previously filed herein, simply requests, without any support, that if the Court finds the G1 design products do infringe, the royalty rate from the jury's verdict in February 2004 should be applied to all G1 design product sales. IRC pointed out in its opposition that the record is devoid of any of the evidence Plaintiff's own expert required to render his evaluation in the case in chief as to the

external pump products. It is telling that Plaintiffs' reply to IRC's opposition fails to address this issue at all and thereby admitting that the record is, in fact, without of any evidence upon which this Court, or any trier of fact, could render a determination as to the applicable reasonable royalty rate for the G1 design products sold after January 1, 2004. As the Court is aware, the G1 design product is a significantly re-designed product, with the entire pump and valve structure reconfigured to be completely within the mattress itself. As is readily apparent, many of the factors, such as costs, advantages, profit margins, etc., must be different for this redesigned product. Thus, as the Court has now found that the G1 design products infringe the '726 patent and ordered an accounting, IRC requests that any award of damages arising out of the sales of G1 design products be stayed until the Court can conduct a full evidentiary hearing on the applicable royalty rate.

II. THERE IS NO BASIS TO APPLY THE ROYALTY RATE FOR EXTERNAL PUMP TO G1 DESIGN PRODUCTS.

A. Plaintiffs Relied Upon Extensive and Detailed Information In Order To Calculate Its Claimed Reasonable Royalty Rate.

35 U.S.C. § 284 provides that in the event of finding infringement, the court shall award damages "adequate to compensate" the claimant, but "in no event less than a reasonable royalty." Section 284 goes on to state that the court may receive expert testimony as an aid to the determination of damages or of what royalty would be reasonable under the circumstances. At the heart of the analysis is the requirement that the royalty be "reasonable" under all the circumstances. Trell v. Marlee Electronics Corp., 912 F.2d 1443, 1446 (Fed. Cir. 1990). As the Court is aware, at trial both sides proffered expert testimony as to the royalty rate that should be applied and the basis thereof. The research and evaluation necessary to make that calculation was extensive. In fact, Aero's own expert, Mark Peterson, testified that he and his

company expended over 1100 hours of time (Tr 476) to prepare that analysis.¹ Mr. Peterson himself expended over 350 hours in preparing these calculations and his two reports. Id.

It is clear from the analysis of Mr. Peterson and his company that they were required to review extensive and detailed information in order to render the opinion contained in the two reports and as testified to at trial. (Tr 481). Moreover, Mr. Peterson emphasized throughout his testimony that in rendering a valuation opinion such as in the instant action, one must always do so in the “context” of the overall market, etc. (Tr 477). Thus, it then follows that in order to determine the applicable royalty rate for the G1 design products, such must also be done in the “context” of the sales of those products, not another product. This is particularly true in this instance of the G1 design products, with their significant re-design of the pump and valve housing, must require another analysis of the manufacturing and sales costs, the applicable margins as well as the “selling decisions” of the consumers which Mr. Peterson extensively reviewed as to the external pump product. It goes without saying that the design entails a different analysis, which is absent here.

Furthermore, it also follows that this “context” would include information relative to the sales at Wal-Mart, the largest customer of IRC for the accused products at trial, as well as its other customers. Indeed, Mr. Peterson’s analysis at trial entailed such an analysis of both Wal-Mart and the “other” sales of accused products (Tr 482). As to the Wal-Mart sales, Mr. Peterson testified that he reviewed very detailed reports generated by Wal-Mart that included a breakdown of its sales not only by store, but by “modules” as well. (Tr 487-488). This detailed analysis was required since not all of the accused products, as well as Aero’s own products, were in each Wal-Mart store, let alone on each module. (Tr 487-488, 495-496). As a result of this review and analysis, Mr. Peterson was able to rank the airbed sales at Wal-Mart not only as between IRC and Aero, but also regarding other competitors. (TX 420A). This

¹ For the Court’s convenience, attached to this memorandum as Exhibit “A” are the cited excerpts from the trial transcript and copies of the cited trial exhibits are attached hereto as Exhibit “B.”

included an evaluation of Wal-Mart's sales at a module level, as well as a "recalculation" of Wal-Mart's sales based upon this analysis. (Tr 497).

The foregoing information was critical to Mr. Peterson's analysis of the percentage of sales that IRC would presumably lose if it removed its accused products. That information was then utilized in his evaluation of what would be reasonable royalty.

In the same vein, Mr. Peterson also used information that he reviewed or extrapolated from other materials produced in this matter to "estimate" the manufacturing costs for the external pump products of IRC's supplier. (Tr 499).

Furthermore, his analysis included not only the profits of IRC for the external pump products, but also of Aero on its products. He thereupon used such, along with the foregoing information, to reach his conclusion as to the maximum royalty IRC would have, theoretically, accepted, (Tr 502; TX 422B), and the minimum royalty Aero would have, theoretically, agreed to. (Tr 505-507; TX 440).

B. There Is No Evidence To Support Claimed Royalty Rate.

As to the G1 design products, Plaintiffs have offered no evidence to justify the imposition of the identified royalty rate as to this completely different product. The expert reports and testimony in this action were predicated upon specific information relating to the external pump product, its placement on the various retailers' shelves and estimated manufacturing costs. No analysis has ever been performed by any expert regarding these specific issues as to the sale of the G1 design products. Accordingly, Plaintiffs have failed to provide this Court with any basis upon which to determine a royalty rate, let alone any basis upon which to blindly adopt the rate awarded by the jury as to a completely different product.

As Mr. Peterson remarked at trial, his analysis of the market, and the basis of his opinions, had to be made for a "very defined period." (Tr 479). The results of his analysis of the various factors identified in Section II, A, above, were presented to the jury and, presumably, were relied upon in reaching the verdict.

It is clear, therefore, that a calculation of a reasonable royalty for sales of G1 design products cannot be derived from the information from the sale of external pumps from 2000 through 2003. The G1 design products were sold at the same time, and to the same customers, as the remaining inventory of the external pump product adjudicated at trial. This must affect the analysis as it relates to sales by IRC as well as its competitors. As recited above, no information as to the sales of the G1 design products, no Wal-Mart module sales information or per store sales have been reviewed to determine any of the foundational information originally relied upon by Mr. Peterson. It is also telling that Aero has failed to provide any support or explanation as to why the jury's determination as to a royalty for the external pump should be applied to a completely re-designed product, sold at different prices and four years after the initial introduction of the external attached pump products.

Aero is requesting this Court to apply the jury's apparent royalty rate to the G1 design products in a vacuum, without any basis on the record. Thus, the Court's award should properly only be predicated on a complete record, with the requisite evidentiary showing.

III. CONCLUSION.

Based upon the foregoing, it is respectfully requested that the Court's award of damages arising from the sale of G1 design products after January 1, 2004 be stayed until the Court can entertain an evidentiary hearing as to the applicable reasonable royalty rate.

Respectfully submitted,

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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

AERO PRODUCTS INTERNATIONAL, INC., a
Florida corporation, and
ROBERT B. CHAFFEE, an individual,

Plaintiffs,

v.

INTEX RECREATION CORP., a California
Corporation, QUALITY TRADING, INC., a
California corporation, and WAL-MART
STORES, INC., a Delaware corporation,

Defendants.

No. 02 C 2590

Chicago, Illinois
February 23, 2004
9:55 a.m
Trial

VOLUME 4

TRANSCRIPT OF PROCEEDINGS
BEFORE THE HONORABLE JOHN W. DARRAH, and a jury

APPEARANCES:

For the Plaintiffs: BRINKS, HOFER, GILSON & LIONE, by
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Peterson - direct

1 Q Did you do all of the work on this case yourself?

2 A No, I didn't. I had a team of people who assisted me in
3 this case. And I might use the word "we" sometimes in my
4 testimony, and that's really meant to refer to myself and my
5 associates as opposed to myself and Aero or myself and Aero's
6 counsel.

7 Q Could you describe the types of information you considered
8 in forming your opinion?

9 A Yes. We started -- we went to websites of the major
10 competitors in this business. We looked at all of the
11 documents that were produced by Intex, Aero, Wal-Mart,
12 Coleman, others. And we read the depositions of the people
13 who were involved, and I read most of those depositions
14 personally.

15 We went to stores, in fact, and looked at products as
16 they were sold on the shelf.

17 Q Approximately how many hours have you and your team spent
18 preparing your opinion in this matter?

19 A Well, we have over 1100 hours as a team in this, and I
20 personally have over 350.

21 MR. REMUS: Your Honor, at this time we'd tender
22 Mr. Peterson as an expert in the valuation of intellectual
23 property.

24 THE COURT: Mr. Makous, do you wish to voir dire the
25 witness?

Peterson - direct

1 MR. MAKOUS: No objection, Your Honor.

2 THE COURT: I find that Mark Alan Peterson is an
3 expert in the area of valuation of intellectual property.

4 You may proceed.

5 BY MR. REMUS:

6 Q Mr. Peterson, did you form an opinion about a royalty that
7 Aero is entitled to if Intex is found to have infringed Aero's
8 patent rights?

9 A Yes, I did.

10 Q And what is that royalty?

11 A Well, essentially, that the royalty should be 15.7 percent
12 of the accused sales. The accused sales is a matter of about
13 21.8 million.

14 Q Could you explain to the jury the importance of context in
15 forming your opinion?

16 A Yes. Whenever I teach a seminar on valuing intellectual
17 property, one of the first concepts that I think you want to
18 cover is the idea of context. And context is very important
19 because in doing a valuation you can make certain assumptions
20 and depending on what assumptions you make or why you're doing
21 the valuation you might come to different conclusions.

22 As an analogy, and I use this sometimes, if you were
23 to think about a watch, let's pretend you own a watch, and the
24 watch is just a basic watch, and it's the same kind of watch
25 that's been made for, say, the last 60 years, 70 years, and

Peterson - direct

1 context that they were done. If I just asked you simply what
2 do grandfathers' watches usually go for, you know, you might
3 come up with a different number than I said value that watch
4 as a timepiece.

5 So in this case the context is Intex's use of Aero's
6 intellectual property in a very defined time period. It's not
7 a more broad based type of valuation.

8 Q And to apply your analogy to this case, is effectively the
9 '726 technology the watch that you just described?

10 A Yes, that would be the analogy.

11 Q And in forming your opinion, did you consider the
12 importance of that technology to Aero and then the importance
13 of that technology to Intex?

14 A Yes, we did. That would be a standard thing I would do in
15 a valuation.

16 Q Mr. Peterson, did you help prepare an exhibit that
17 summarizes how you arrived at your opinion?

18 A Yes, I did.

19 MR. REMUS: Jim, could you please display Trial
20 Exhibit 435 A?

21 BY MR. REMUS:

22 Q Mr. Peterson, could you, using this exhibit, explain to
23 the jury how you arrived at your opinion?

24 A Well, essentially there are a variety of facts that we
25 wanted to deal with, and we start out with what I'll -- in the

Peterson - direct

1 Q Thank you.

2 Mr. Peterson, prior to forming your opinions in this
3 matter, did you study the competition between Aero and Intex?

4 A Yes, we did. We studied how they looked on the shelves.
5 We looked at all the documents that talked about competition.
6 We've seen a number of them projected on the screen in this
7 case so far. And we did study that in great detail.

8 Q Did you find that Aero and Intex shared any common
9 customers?

10 A Yes. Obviously, there will be definitions of common
11 customers. We define common customers as customers who were
12 willing to buy products from both parties. So we could look
13 at the sales records, and we could see that in fact the
14 customers was willing to buy an Aero product, they were
15 willing -- and put that on their shelf or in their catalog,
16 and the customer was also willing to purchase Intex products.

17 Q And were you able to quantify how much of an overlap there
18 was between Aero's customers and then customers of the accused
19 Intex products?

20 A Yes. Well, remembering, you know, to take it back to
21 that, what we're looking at is the accused sales, so I try to
22 refer to, you know, what of those accused sales, how many of
23 those accused sales were sold to common customers and then how
24 many of those accused sales were sold to customers where, say,
25 Aero wasn't able to sell. And of those sales, approximately

Peterson - direct

1 87 percent of the accused sales were sold to customers who
2 also bought product from Aero.

3 Q What percentage of the accused sales were made to
4 Wal-Mart?

5 A 67 percent.

6 That's a very important point in this case. Because
7 Wal-Mart was such a big customer, we basically in doing our
8 analysis divided it into two pieces, Wal-Mart and everybody
9 else, because we believe that you needed to look at those two
10 pieces separately.

11 Q Now, Aero wasn't selling its airbeds in Wal-Mart during
12 the entire period of infringement, were they?

13 A That's correct. They were not.

14 Q Did you see any evidence that Aero had to compete for
15 shelf space or that Aero would have been in Wal-Mart sooner
16 but for Intex's accused sales?

17 A Well, we certainly saw there were at least some
18 correspondence between the parties, and I'd spoken with Aero
19 people about this issue, and the fact is that in early 2000
20 Aero was making a pitch to sell their airbeds to Wal-Mart, and
21 there are documents that suggest that they were looking to do
22 that, and it was right after that that Intex actually
23 successfully made the sale of their accused products.

24 Q Did you see any evidence that Aero had to compete with
25 Intex in any catalogs?

Peterson - direct

1 A Right. The customers who bought the accused, 87 percent
2 of the accused products were sold to customers who also bought
3 Aero products.

4 Q And then there was another 13 percent there that did not
5 overlap?

6 A Well, yes, there's another 13 percent that didn't ever
7 purchase from Aero, which doesn't mean that Aero didn't go in
8 and try to make that sale, but we didn't see evidence of that
9 specifically.

10 Q Do Aero and Intex have to be competing in the same stores
11 and on the same shelves in order for there to be competition
12 between the two companies?

13 A No, certainly not. There's documents in the case, a
14 number of them, I think there was one put up the other day,
15 which talked about how Aero had come in -- or Intex had come
16 in the day after Aero made a presentation and offered Mervin's
17 or somebody the product for a lower price and in effect
18 knocked Aero out.

19 Q Did you see any evidence that customers were willing to
20 pay more for the features of the '726 patent?

21 A Yes, I did.

22 Q What was that evidence?

23 A Well, in the documents that were produced to us by
24 Wal-Mart, there was a group of documents which we'll talk
25 about, the modular sales analysis, and these were pretty

Peterson - direct

1 detailed sales records, and when you look at specific
2 comparisons, for example, the raised queen bed was sold both
3 with the accused feature and without the accused feature, and
4 despite being higher priced and despite -- so you would expect
5 that might not sell as well, the accused product actually sold
6 much better on a comparison basis.

7 MR. REMUS: With that background, Jim, could you put
8 up Trial Exhibit 435 A?

9 BY MR. REMUS:

10 Q And this was the summary we looked at. Now, going back to
11 this summary, could you explain what the first step was in
12 your analysis?

13 A Well, the first step was to look at the actual licensing
14 policies that were, you know, in effect and look at the
15 licenses, that it's changed hands. And when we looked at all
16 of the licenses, and there's been some testimony, Mr. McColgan
17 talked about them in some length, but particularly the Coleman
18 license, the license between two parties who at the beginning
19 weren't competitors and then later on became competitors.
20 They ended up on the same page of the catalog. And so we
21 started to focus on the Coleman license because it was a
22 competitive license.

23 Q And what did the Coleman license tell you about what an
24 appropriate royalty should be?

25 A Well, when we looked at the Coleman license, we saw that

Peterson - direct

1 get into Wal-Mart or any other retailer, that they would in
2 fact lose 65 percent of those sales.

3 Q And is the other side of that coin that Intex would keep
4 35 percent of their sales?

5 A Yes, yes.

6 Q How, specifically, did you arrive at this number of 65
7 percent?

8 A Well, basically what we did was we went through -- and I
9 talked earlier -- a little bit earlier about these modular
10 sales analyses that Wal-Mart produced.

11 First we separated our analysis into both Wal-Mart
12 and non-Wal-Mart. And I'll talk first about the Wal-Mart
13 because, obviously, they're the biggest portion, and we
14 actually had the most detailed records with respect to
15 Wal-Mart.

16 And the Wal-Mart sale -- they had these reports they
17 called modular sales analysis, and basically what a modular
18 sales analysis, if you walk into a Wal-Mart store, you'll be
19 confronted with either four feet of width of shelf that has
20 airbeds on it, eight feet of shelf that has airbeds on it, 12
21 feet or 16 feet, depending on which Wal-Mart store you walk
22 into, where you walk into those stores. And so one of the
23 things we discovered very quickly early on was that the
24 four-foot module doesn't contain any of the accused products.
25 They aren't sold in the four-foot modules. So then we were

Peterson - direct

1 able to sort of take that out of the equation and look at the
2 eight-foot module, the 12-foot module and the 16-foot module
3 with a great deal of precision.

4 And the other thing that these documents did is it's
5 important to note that all of the products aren't in all of
6 the stores. So if Wal-Mart has 2800 stores, obviously, a
7 product that sells in all 2800 will have a better chance of
8 having high sales than a product that sells in, you know, only
9 a thousand stores or even some lower number.

10 But what these documents did was then they took the
11 sales at each store and -- in each module and they add them up
12 and divided by the number of stores so you could see how well
13 a product sold. Even if it didn't sell in all 2800 stores,
14 you could make a very detailed comparison. And that was the
15 -- what we used as really the basis for looking at how do the
16 products compete.

17 And in 2003, that's when Aero started selling, so we
18 were able to look at their modular sales analysis in 2003 and
19 make some pretty good comparisons.

20 Specifically, after -- now I've explained, you know,
21 the documents we used to look at. Then specifically what we
22 did was fairly standard technique for going in and saying,
23 okay, what would happen if you pulled the accused products out
24 of the mix and recalibrated the market shares. How much would
25 Coleman get, how much would Intex get, and how much would Aero

Peterson - direct

1 get.

2 And we did one other thing, which was to note that --
3 and I pointed out earlier the ten-dollar low-priced bed. We
4 sort of pulled out the vinyl bed from Intex, and we said
5 that's no way that's really competing. While I think I see
6 competition as sort of a continuum, we believe that that
7 wasn't really a competitive bed.

8 And so when you then recalibrate these market shares,
9 you get pretty much 65 or 60 to 65 percent, and so we used 65
10 percent.

11 Q Did you then take this 65 percent number, multiply it by
12 the profits in order to determine the value to Intex of taking
13 a license under that patent?

14 A Well, yes, that would be the logical next step.

15 Q Did you determine the profitability of Intex's accused
16 products?

17 A Yes, we did.

18 Q What did you determine that profitability was?

19 A Well, we used -- we determined their profitability was in
20 the range of 30 percent. There's a variety of things that we
21 did to arrive at that.

22 Q How did you arrive at that number?

23 A Well, we started by looking at Intex's overall financial
24 statements. And one of the things that you note when you look
25 at Intex's overall financial statements is that they -- or at

Peterson - direct

1 least -- and when I say Intex here, I'm referring to Intex
2 Recreation Corp. based in Long Beach. And their financial
3 statements firm-wide show in almost every year under a two
4 percent profit. They make very little money.

5 And then if you look at the products on a profit line
6 basis -- or product line basis so you can just look at
7 airbeds, you'll see that they, again, make very little money,
8 under -- generally under five percent.

9 We heard Mr. Makous in opening argument say that
10 Intex's profits are 10.10 percent roughly, and those numbers
11 don't come from their financial statements. They come from an
12 adjustment to their financial statements. So, you know, we've
13 already made that move.

14 In looking at the profits of Intex, one of the things
15 that we were very aware of was that all we were allowed to see
16 were the landed costs. And that's a term that they use that
17 basically means when the product lands in Long Beach, they get
18 charged by one of the other Intex sister companies a certain
19 price. That price is -- then determines basically their cost
20 of goods sold. So that's their input price.

21 Now, we weren't allowed to see any of the financial
22 statements of any of the other Intex companies, so the only
23 price we could, you know, actually look at were those prices.

24 But in going through the documents in the case, we
25 discovered there was a study that was done by Wal-Mart.

Peterson - direct

1 Because, as I think we all know, Wal-Mart is consistently
2 interested in lowering their prices and getting lower prices
3 from their vendors, and so they had done a study of what would
4 happen if they decided to replace Intex. So they priced out
5 what they thought the bed should cost as a tool to help either
6 lower prices from Intex or potentially find another supplier.

7 Q And what did this Wal-Mart study tell you?

8 A Well, basically the implication from the study was that
9 there was about a 29.7 percent profit margin built into these
10 beds; that if Wal-Mart would import, bring the beds into their
11 place themselves, then they would in fact save a lot of money.

12 Now, one of the places they went to get this
13 information, they got two competitive prices, and they also
14 went to Intex's manufacturing plant and got a quote directly
15 from them.

16 So we went and looked at the analysis and were able
17 to come up with the fact that in general this study suggested
18 that the profits were probably closer to 30 percent than ten
19 percent or two percent.

20 Q Now, the study that Wal-Mart did, they looked at -- this
21 particular study, was a nonaccused product; is that right?

22 A Yes.

23 Q Do you see any reason to believe the profitability would
24 be any different for a nonaccused airbed versus an accused
25 airbed?

Peterson - direct

1 companies, and he said, yes, sometimes I have to negotiate
2 with myself. I have to approve both of these prices.

3 So in fact, you know, there is evidence that the
4 prices can be set basically wherever anybody wants to.

5 Q Mr. Peterson, did you help prepare an exhibit that then
6 applies these profitability numbers you calculated with the
7 lost sales that Intex stood to lose?

8 A Yes, I did.

9 MR. REMUS: Jim, could you display Trial Exhibit 441?

10 BY MR. REMUS:

11 Q Now, could you explain to the jury what Trial Exhibit 441
12 shows?

13 A Yes. We simplified -- remember I said that we did our
14 analysis of both Wal-Mart and other companies, and you'll
15 notice that we expected that basically Intex would lose about
16 65 percent in both cases. And the profitability is 30.5
17 percent, which is really an average of two different profit
18 numbers. And when you weight that to get the proper number,
19 rather than putting up a lot of confusing math on the board,
20 basically we've simplified this, and that comes out to a 19.9
21 percent maximum acceptable royalty to Intex.

22 And that's saying that in an economic concept if they
23 paid more than that, they probably shouldn't. They probably
24 should reject a license at that point, at least in a
25 negotiating sense.

Peterson - direct

1 BY MR. REMUS:

2 Q. Mr. Peterson, how does this chart explain your analysis?

3 A. Well, basically remembering that what we're talking about
4 is sales of common customers, but what we've added here, we're
5 not just talking about the accused product; we're talking about
6 places where Intex sells the accused product along with
7 nonaccused products. That would be Wal-Mart. That's sort of
8 -- those type of companies are the bar on the left-hand side of
9 the chart.

10 If you look at that bar, you see that Aero in its
11 market share relative to Intex takes about 27 percent of the
12 sales at those common customers and then accordingly loses 73
13 percent of the sales. But when you go to companies like Target
14 where Intex does not sell the accused product -- and there are
15 a lot more companies than Target, but I use that that as a
16 similar example -- you see that Aero ends up selling 63 percent
17 of the dollar sales as opposed to then Intex correspondingly
18 gets 37 percent. So that yellow area of the difference is the
19 difference between what happens when Intex sells the accused
20 product and when they don't.

21 Q. And did you then use Aero's profits to determine or to
22 quantify how much money it would be losing by licensing a
23 competitor?

24 A. Yes, we did. We looked at Aero's profits and looked at
25 what profitability was most likely to be applicable at

Peterson - direct

1 Wal-Mart, and then based on the types of beds they sold there,
2 and then what profitability was supposed to be in other areas,
3 you know, and we were able to make a comparison.

4 MR. REMUS: Jim, could you display Trial Exhibit
5 435D? Excuse me. I'm sorry. It's 440.

6 (Brief pause.)

7 BY MR. REMUS:

8 Q. Could you explain how you performed this calculation on
9 Trial Exhibit 440?

10 A. Certainly. At Wal-Mart, we thought that Aero would
11 actually get a 15 percent margin, and that's based on, you
12 know, the competitive situation at Wal-Mart and a very detailed
13 review of the modular sales analysis and other items. Then we
14 looked at how Aero sold, you know, in other places outside of
15 Wal-Mart. We believe that basically 25 percent was the amount
16 that made sense there, and we did a variety of tests in our
17 analysis to suggest that that was, in fact, a reasonable
18 opinion, considering all the evidence.

19 When you weight those two numbers and then come down,
20 you come up to a minimum acceptable royalty of about 6.76
21 percent, and that royalty, similar to the Aero number, is sort
22 of saying -- or the Intex number that we talked about earlier
23 is saying where would or what royalty is just too low for Intex
24 in the competitive situation, I mean, where should they walk
25 away from the deal and just say: No, we won't grant a license.

Peterson - direct

1 So that's at 6.76 percent.

2 Q. And this is an approximation of the minimum that Aero would
3 accept in a negotiation for a royalty?

4 A. Certainly.

5 MR. REMUS: Jim, could you take us to 435D which is
6 Mr. Peterson's summary chart?

7 BY MR. REMUS:

8 Q. We just finished the importance to Aero. What was the next
9 step in your analysis?

10 A. Okay. Well, now we come down to what's known as the
11 hypothetical negotiation. Thinking back to the watch analogy,
12 this is now where we force you, even though you don't want to
13 sell your grandfather's watch, your Harry Truman watch, to
14 actually come to a negotiation.

15 We have to assume some things. The first thing we
16 assume is that the patent is valid and infringed, and that's
17 something that generally isn't in a normal negotiation. When I
18 assist clients who are negotiating things, generally when the
19 parties walk into the room, the first thing the guys say is:
20 Well, your patent is invalid, so we'll pay you a couple of
21 pennies to save lawyer fees.

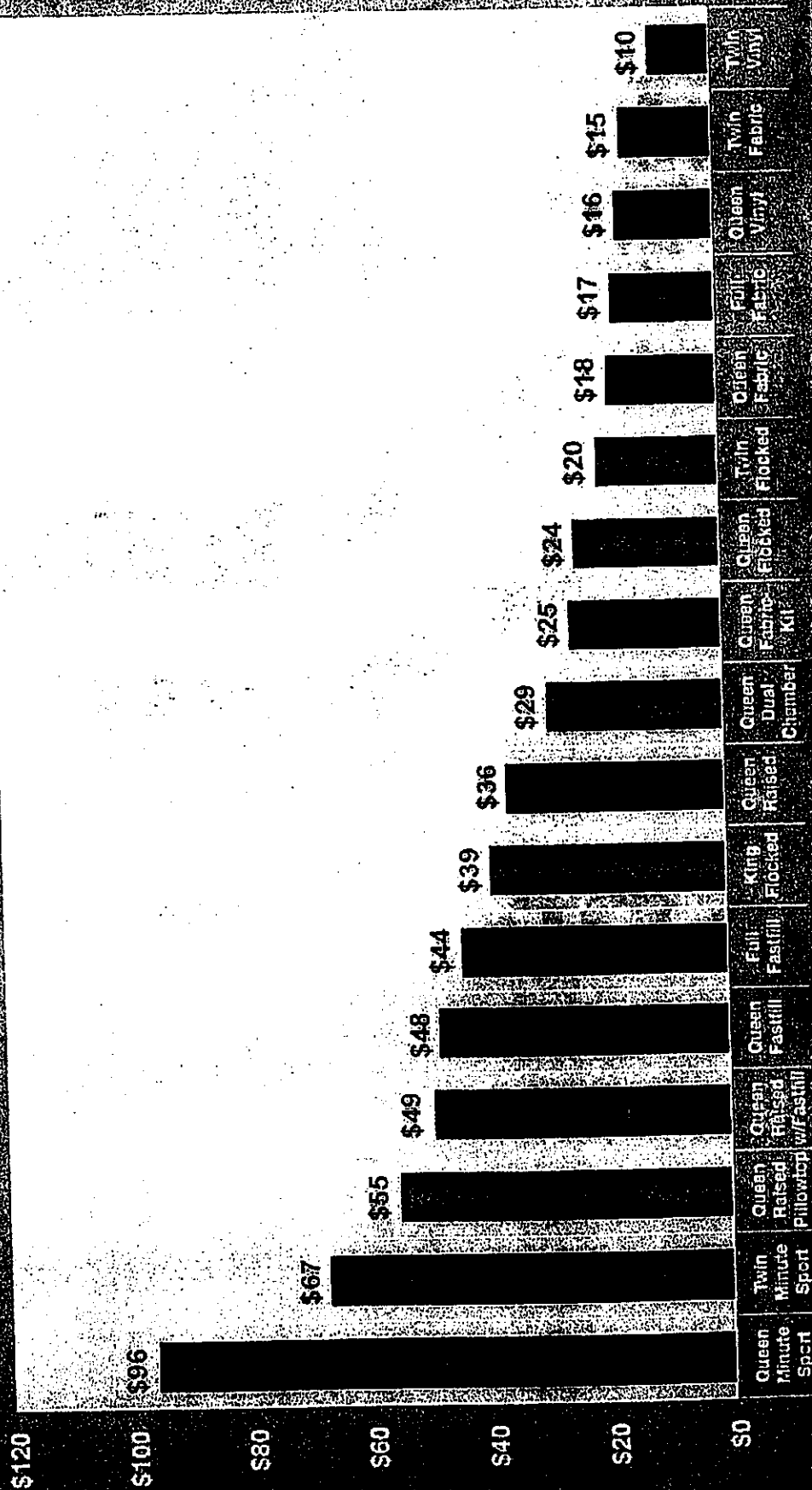
22 Then the other guy says: Well, you know, you're
23 going to get hit with an injunction.

24 So there's a give-and-take. In this type of a
25 hypothetical negotiation in a courtroom setting, we have to

B

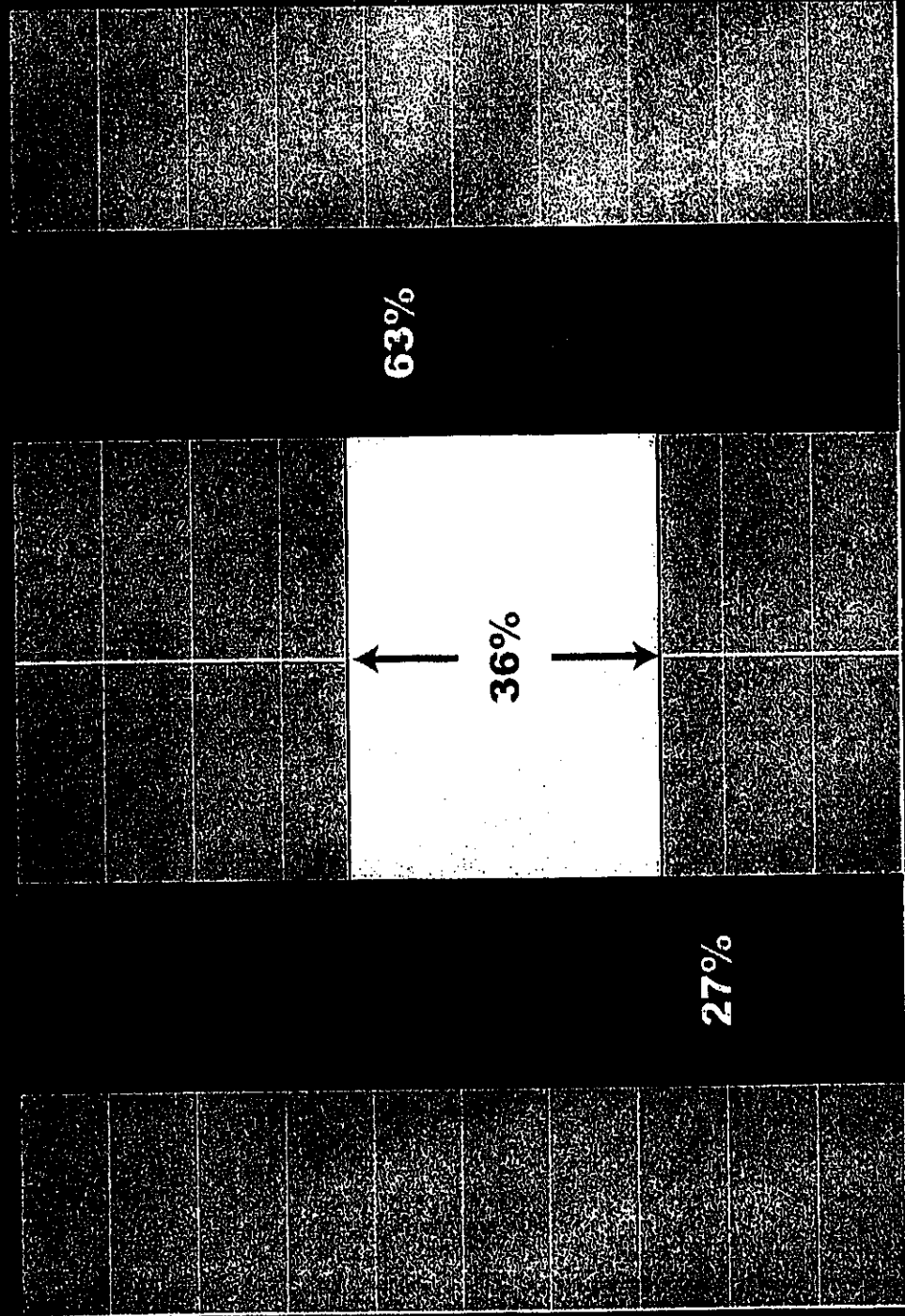
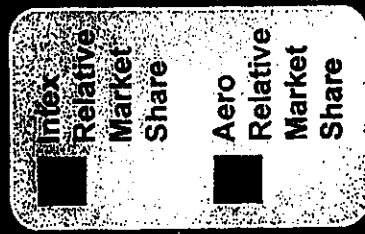
Airbeds Ranked by Price at Wal-Mart

Aero Intex Coleman



Source: Bates WM 000451-156

Aero vs Intex: Head-to-Head Competition



Intex Sells
Accused Product

Intex Does Not
Sell Accused Product

TX 422B

Aero's Minimum Acceptable Royalty

Aero's Lost Sales %
Profit %

	<u>Wal-Mart</u>	<u>Others</u>
	15.0%	25.0%
	x 33.1%	x 41.9%
	<u> </u>	<u> </u>
	↗	↘
Aero's Minimum Acceptable Royalty	6.76%	

IN THE UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

Aero Products International, Inc., a Florida corporation, and Robert B. Chaffee, an individual,)	
)	
)	Case No.: Case No. 02 C 2590
)	
Plaintiff,)	
)	
vs.)	
Intex Recreation Corp., a California corporation, Quality Trading, Inc., a California corporation, and Wal-Mart Stores Inc., a Delaware corporation,)	Judge John W. Darrah
)	
)	
)	Magistrate Judge Geraldine Soat Brown
Defendants.)	
)	

CERTIFICATE OF SERVICE

I hereby certify that a copy of the attached:

- **NOTICE OF PRESENTMENT OF MOTION OF DEFENDANT INTEX RECREATION CORP. TO STAY AWARD OF DAMAGES FOR G1 SALES PENDING AN EVIDENTIARY HEARING**
- **MOTION OF DEFENDANT INTEX RECREATION CORP. TO STAY AWARD OF DAMAGES FOR G1 SALES PENDING AN EVIDENTIARY HEARING**
- **[proposed] ORDER STAYING AWARD OF DAMAGES FOR G1 SALES PENDING AN EVIDENTIARY HEARING**
- **MEMORANDUM IN SUPPORT OF MOTION OF DEFENDANT INTEX RECREATION CORP. TO STAY AWARD OF DAMAGES FOR G1 SALES PENDING AN EVIDENTIARY HEARING (Including Exhibits A and B thereto)**

were served upon Plaintiffs Aero Products International, Inc. and Robert B. Chaffee via hand delivery to their attorneys at the following address on the date indicated below:

William H. Frankel
Michael P. Chu
David H. Bluestone
Mark H. Remus
Christopher M. Dolan
Brinks Hofer Gilson & Lione
NBC Tower, Suite 3600 - 455 North Cityfront Plaza Drive
Chicago IL 60611-5599

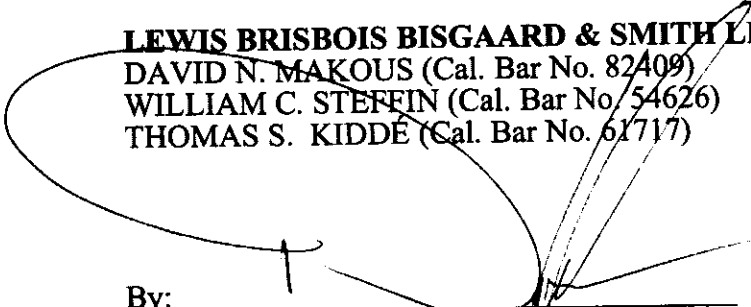
Copies of documents required to be served by Fed.R.Civ.P. 5(a) have been served.

LEYDIG, VOIT & MAYER, LTD.
MARK E. PHELPS
M. DANIEL HEFNER

LEWIS BRISBOIS BISGAARD & SMITH LLP
DAVID N. MAKOUS (Cal. Bar No. 82409)
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THOMAS S. KIDDE (Cal. Bar No. 61717)

DATED: June 1, 2005

By:



M. Daniel Hefner
Attorneys for Defendant and Counterclaim
Plaintiff Intex Recreation Corp., and
Defendants Quality Trading Inc. and Wal-
Mart Stores, Inc.